

The Other Side of the Street May 13, 2009

Overview Comments

Sorry I did not get out anything last weekend. To be honest I was still in shock from the week past. Pretty much every day I endured 30% gap up moves in garbage stocks. If it had a short interest it got jammed.

I have been in the game long enough to know that such things happen when there are way too many shorts in bad companies. It does not matter than the company is a disaster as long as those who manipulate markets can push prices up to a threshold where shorts begin to cover. It then becomes an orgy. That is how the banks stocks, the garbage REITS and the Vegas insolvents went up 2-300% in days.

However things that go up for no supportable reason quickly collapse once the short squeeze has run its course. That and not any “news” is why the same garbage is falling double digits or more per day.

So much for efficient market theory . . .

Macro Thoughts

I have stopped reading much of the longer term financial picture. It is too grim even for me. A few points to ponder . . . Social security is basically going under years earlier than previously thought. And the latest projections optimistically project that the recession ends in 2009 . . . the state of California will be in essence insolvent (bills much larger than ability to pay by over 20B by JULY . . . Moody’s has opined the U.S. is in danger of losing its triple A rating . . . the U.S. collects a trillion in taxes without including FICA. At 10 trillion in debt and counting and assuming interest can be held at 4% (won’t happen it will be much higher) 40% of receipts are needed to pay interest . . . like I said, I don’t even want to read more . . .

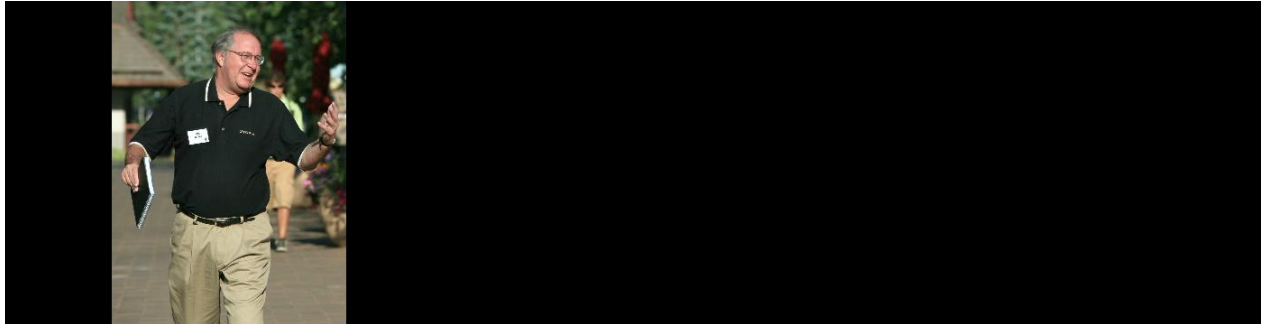
Topics of interest

Let’s see, Meredith Whitney who was alone in warning about the collapse of the banks last year versus the worst investor of the last 3 years. Meredith who said run away from Bear Stearns, Bill who was buying it up to go with his Fannie Freddie, Countrywide, etc. I think you already know where I stand . . .

Miller Wrestles Whitney in Showdown Over Bank Stocks (Update4)

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By Michael Tsang



May 13 (Bloomberg) -- The returns on Legg Mason's [Value Trust](#) mutual fund depend on [Bill Miller](#) being right about bank stocks and [Meredith Whitney](#) being wrong.

Miller, who beat the [Standard & Poor's 500](#) Index for a record 15 straight years before stumbling in 2006, says financial companies are his favorite investment for the rest of the decade. Whitney, the former [Oppenheimer & Co.](#) stock analyst who became one of Wall Street's first bears when credit markets started to freeze in 2007, said banks are "grossly overvalued" after government evaluations of their financial health.

The stakes are greater for Miller, 59, who lost [more money](#) in the past three years than 99 percent of rival managers by owning [Bear Stearns Cos.](#), [Freddie Mac](#) and [American International Group Inc.](#), according to data compiled by Bloomberg and Morningstar Inc. Whitney, 39, proved prescient by telling her clients to avoid [Citigroup Inc.](#), [Wachovia Corp.](#) and [UBS AG](#), which lost at least two-thirds of their value last year.

"It could be Bill is right and the vast majority of banks will [earn](#) their way out of this," said [William Stone](#), chief investment strategist at [PNC Financial Services Group Inc.](#)'s wealth management unit, which oversees \$96 billion in Philadelphia. "But if the economy takes another nosedive and the adverse feedback loop begins again with a vengeance, then maybe it's Meredith."

Miller declined to comment, while Whitney didn't return phone calls or an e-mail message seeking comment.

Bad Bets

Miller, a so-called value investor who seeks the cheapest companies relative to earnings or assets, posted the [worst returns](#) within his fund's category in the past three years, data compiled by Chicago-based research firm Morningstar show.

The fund lost 55.1 percent in 2008 after Miller underestimated the magnitude of the worst financial crisis since the Great Depression. In April last year, a month after [Bear Stearns](#) collapsed and was taken over by [JPMorgan Chase & Co.](#), he wrote in a letter to fund shareholders that "we have seen the bottom in financials."

The S&P 500 has tumbled 36 percent since then, with a measure of banks plummeting 56 percent. Today, the S&P 500 fell 2.7 percent to 883.92. Financial stocks dropped 5.2 percent, the biggest decline of 10 industry groups in the broader index.

Miller [boosted](#) his stake in McLean, Virginia-based Freddie Mac, once the second-largest U.S. mortgage-finance company, to 17.7 million shares from 5.9 million shares in the first half of 2008, Securities and Exchange Commission filings show.

Most Upside

Miller's holdings in New York-based [AIG](#), once the world's biggest insurer, also increased to 9.68 million shares from 8.45 million shares at the end of 2007. Both companies were taken over by the government in September.

"He's made massive bets in institutions that were wiped off the face of the exchange," said [Frederic Dickson](#), who helps oversee \$20 billion as chief market strategist at D.A. Davidson & Co. in Lake Oswego, Oregon.

This year, Miller's fund has gained [8.1 percent](#), putting him among the top 10 percent in his category, according to data compiled by Morningstar.

"[Financials](#) have the biggest potential to outperform," he said last week, naming his favorite picks as San Francisco-based [Wells Fargo & Co.](#), Capital One Financial Corp. in McLean, Virginia, and New York-based American Express Co.

Home Prices

Miller's bets hinge on U.S. [home prices](#) stabilizing this year and an economy that performs better than projections from the Federal Reserve. The central bank [said](#) in January that gross domestic product will shrink by 0.5 percent to 1.3 percent in 2009. Miller projects U.S. equity markets will rise 20 percent to 30 percent in 2009.

More than 19 percent of the [Value Trust](#) was invested in financial stocks at the end of the first quarter, according to Legg Mason Inc.'s Web site, greater than their 12.8 percent [share](#) of the S&P 500 now.

In the first three months of 2009, Miller bought about 3.77 million shares of Wells Fargo, the largest U.S. mortgage originator, and almost quadrupled his position in credit-card company Capital One, according to data compiled by Bloomberg and Legg Mason's [Web site](#). Miller also increased his stake in American Express, the biggest U.S. credit-card company by purchases, by about 22 percent, the data show.

Since March 31, [Wells Fargo](#) has gained 70 percent. [Capital One](#) rose 96 percent, while [American Express](#) added 77 percent.

Survival of the Fittest

Today, Wells Fargo lost 5.8 percent, while Capital One slipped 6 percent and American Express decreased 5.3 percent.

Financial [companies](#) in the S&P 500 have increased 87 percent since falling to a 17-year low on March 6 as concern waned that more banks, brokerages and insurance companies will fail during the longest U.S. recession since World War II.

Financial stocks in the S&P 500 traded at 20.45 times estimated 2009 [earnings](#) yesterday, the lowest since Bear Stearns's collapse in March last year.

“When you get past the two-to-three-year horizon where they work through their problems, the valuations today are exceptionally cheap,” said [Scott Minerd](#), chief investment officer at Guggenheim Partners Asset Management, which manages \$30 billion. “Survival for banks is not a question anymore.”

While Miller is beating the S&P 500 for the year, anyone who bought shares of the Value Trust between July 1997 and October 2008 and never sold them has lost money, according to monthly data compiled by Bloomberg and [Morningstar](#). During that period, the index returned more than 20 percent, including dividends. The fund has given up about [\\$17.7 billion](#) of its assets under management since May 2007, or 82 percent.

Earnings Power

Whitney says bank stocks will decline because the gains aren't matched by improvements in their businesses.

“The underlying core earnings power of these banks is negligible,” Whitney, who quit Oppenheimer in February to start her own firm, Meredith Whitney Advisory Group LLC in New York, said in a May 11 interview with CNBC.

U.S. banks will likely return to “negative earnings” after posting first-quarter profits, she said last month. The largest companies must sell assets after expanding at an unsustainable pace in the past two decades.

Home prices are likely to be down 50 percent from peak levels, Whitney said. A recovery in consumer spending, which accounts for 70 percent of the U.S. economy, may be undermined as banks and card companies slash \$2.7 trillion in credit lines by the end of 2010, she wrote in a report e-mailed yesterday.

‘Whitney’s Camp’

That may damp revenue at lenders such as Capital One and [American Express](#). She's sticking by her call even as financials lead the S&P 500's 31 percent rally from a 12-year low in March.

Whitney, who is married to John “Bradshaw” Layfield, a former World Wrestling Entertainment Inc. champion, graduated with honors from Brown University in Providence, Rhode Island, and began her career as a research analyst in 1993.

Whitney predicted in October 2007 that Citigroup would have to cut its dividend, which the bank did in January 2008, by 41 percent. Her recommendation triggered what was at the time the steepest tumble in Citigroup shares since September 2002.

In December 2007, she lowered her rating on UBS because earnings estimates for the largest Swiss bank by assets were “unrealistic.” Last year, the Zurich-based lender reported a per-share loss of 6.92 Swiss francs, 25 percent worse than analysts anticipated. The U.S. shares fell 65 percent, while the local stock declined 68 percent in 2008.

D.A. Davidson’s Dickson says Whitney’s accuracy has made him more skeptical the gain in financial stocks is sustainable.

“I’m pretty much in Meredith Whitney’s camp on this one,” Dickson said. “She’s been dead-on in identifying the problems in the banks. I’m hoping for the economy’s sake and banking’s sake that I’m wrong.”

Markets

Equity

We topped last week. We will go down 2-6 weeks, right about when you start hearing about retesting the lows it won’t happen. The markets will then start a summer rally. It is this rally that matters. IMO it fails and we see new lows and we stay down for a while. There will not be another V shaped 40% run.

Credit

The TBT will (already is) come in. The jump to 53 was a head fake. It will pull back to the 50 DMA around 47. When it does I am going back in. The Fed has already blown 1/3rd of its manipulation money. It does not have the power to hold down the global market in treasuries.

Gold and Silver

Looking like they are getting ready to run again. Oddly I think it unlikely because an equity selloff will hit silver (it has become a “recovery commodity” play). I am willing to wait for these to either come in or go sideways a little. However should gold break 1000 I will chase it.

Trading

Past week

Upcoming week